

AMERICAN GREETINGS CORP

Form 10-Q

January 02, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended November 23, 2007**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-13859**

**AMERICAN GREETINGS CORPORATION**

(Exact name of registrant as specified in its charter)

**Ohio**

**34-0065325**

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**One American Road, Cleveland, Ohio**

**44144**

(Address of principal executive offices)

(Zip Code)

**(216) 252-7300**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of December 27, 2007, the number of shares outstanding of each of the issuer's classes of common stock was:

Class A Common	48,743,833
Class B Common	3,442,145

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**AMERICAN GREETINGS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF INCOME**  
(Thousands of dollars except share and per share amounts)

	(Unaudited)			
	Three Months Ended		Nine Months Ended	
	November 23, 2007	November 24, 2006	November 23, 2007	November 24, 2006
Net sales	\$ 474,995	\$ 510,102	\$ 1,258,829	\$ 1,271,755
Other revenue	10,751	11,052	24,309	26,537
Total revenue	485,746	521,154	1,283,138	1,298,292
Material, labor and other production costs	223,329	245,187	547,509	593,232
Selling, distribution and marketing expenses	159,420	157,364	444,695	451,419
Administrative and general expenses	60,481	65,287	178,291	183,516
Other operating income net	(127)	(20,541)	(807)	(20,963)
Operating income	42,643	73,857	113,450	91,088
Interest expense	4,835	6,951	14,431	27,024
Interest income	(2,115)	(1,258)	(5,834)	(6,716)
Other non-operating (income) expense net	(4,582)	91	(7,478)	(2,811)
Income from continuing operations before income tax expense	44,505	68,073	112,331	73,591
Income tax expense	15,017	21,058	43,495	22,583
Income from continuing operations	29,488	47,015	68,836	51,008
(Loss) income from discontinued operations, net of tax	(472)	2,692	(1,395)	3,593
Net income	\$ 29,016	\$ 49,707	\$ 67,441	\$ 54,601
<b>Earnings per share basic:</b>				
Income from continuing operations	\$ 0.54	\$ 0.79	\$ 1.25	\$ 0.87
(Loss) income from discontinued operations	(0.01)	0.05	(0.03)	0.06
Net income	\$ 0.53	\$ 0.84	\$ 1.22	\$ 0.93

**Earnings per share assuming dilution:**

Income from continuing operations	\$ 0.53	\$ 0.79	\$ 1.24	\$ 0.82
(Loss) income from discontinued operations	(0.01)	0.04	(0.03)	0.06
Net income	\$ 0.52	\$ 0.83	\$ 1.21	\$ 0.88

Average number of shares outstanding	55,022,689	59,502,276	55,350,736	58,590,857
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Average number of shares outstanding assuming dilution	55,466,351	59,902,127	55,726,990	64,361,644
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Dividends declared per share	\$ 0.10	\$ 0.08	\$ 0.30	\$ 0.24
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See notes to condensed consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
(Thousands of dollars)

	(Unaudited) November 23, 2007	(Note 1) February 28, 2007	(Unaudited) November 24, 2006
<b>ASSETS</b>			
Current assets			
Cash and cash equivalents	\$ 71,117	\$ 144,713	\$ 86,216
Trade accounts receivable, net	205,702	103,992	239,207
Inventories	239,209	182,618	244,181
Deferred and refundable income taxes	76,568	135,379	160,983
Assets of businesses held for sale	2,216	5,199	13,310
Prepaid expenses and other	213,529	227,380	295,866
Total current assets	808,341	799,281	1,039,763
Goodwill	267,308	224,105	219,093
Other assets	389,324	416,887	459,269
Deferred and refundable income taxes	111,959	52,869	
Property, plant and equipment at cost	975,721	944,534	968,755
Less accumulated depreciation	684,170	659,462	668,524
Property, plant and equipment net	291,551	285,072	300,231
	\$ 1,868,483	\$ 1,778,214	\$ 2,018,356
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
Current liabilities			
Debt due within one year	\$ 46,490	\$	\$ 142,000
Accounts payable	131,099	118,204	126,956
Accrued liabilities	89,751	80,389	91,108
Accrued compensation and benefits	58,969	61,192	58,720
Income taxes	31,255	26,385	17,412
Liabilities of businesses held for sale	1,383	1,932	1,629
Other current liabilities	96,896	84,898	91,162
Total current liabilities	455,843	373,000	528,987
Long-term debt	200,975	223,915	223,985
Other liabilities	149,869	162,410	101,003
Deferred income taxes and noncurrent income taxes payable	31,877	6,315	25,306

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Shareholders' equity			
Common shares - Class A	49,929	50,839	53,775
Common shares - Class B	3,442	4,283	4,224
Capital in excess of par value	443,326	414,859	417,444
Treasury stock	(780,044)	(710,414)	(643,540)
Accumulated other comprehensive income (loss)	22,982	(1,013)	36,067
Retained earnings	1,290,284	1,254,020	1,271,105
Total shareholders' equity	1,029,919	1,012,574	1,139,075
	\$ 1,868,483	\$ 1,778,214	\$ 2,018,356

See notes to condensed consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
(Thousands of dollars)

	(Unaudited)	
	Nine Months Ended	
	November 23, 2007	November 24, 2006
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 67,441	\$ 54,601
Loss (income) from discontinued operations	1,395	(3,593)
Income from continuing operations	68,836	51,008
Adjustments to reconcile to net cash provided (used) by operating activities:		
Net (gain) loss on disposal of fixed assets	(481)	754
Loss on extinguishment of debt		5,055
Depreciation and amortization	36,002	37,229
Deferred income taxes	(7,994)	5,827
Other non-cash charges	5,719	9,180
Changes in operating assets and liabilities, net of acquisitions and dispositions:		
Increase in trade accounts receivable	(99,268)	(92,821)
Increase in inventories	(49,911)	(27,202)
Decrease (increase) in other current assets	18,090	(96,250)
Decrease in deferred costs net	29,338	110,076
Increase (decrease) in accounts payable and other liabilities	38,295	(5,894)
Other net	4,718	(6,265)
<b>Cash Provided (Used) by Operating Activities</b>	<b>43,344</b>	<b>(9,303)</b>
<b>INVESTING ACTIVITIES:</b>		
Proceeds from sale of short-term investments	692,985	1,026,280
Purchases of short-term investments	(692,985)	(817,540)
Property, plant and equipment additions	(37,394)	(29,600)
Cash payments for business acquisitions, net of cash acquired	(51,256)	(11,154)
Cash receipts related to discontinued operations	4,283	12,559
Proceeds from sale of fixed assets	2,656	695
<b>Cash (Used) Provided by Investing Activities</b>	<b>(81,711)</b>	<b>181,240</b>
<b>FINANCING ACTIVITIES:</b>		
Increase in long-term debt		200,000
Reduction of long-term debt		(440,588)
Increase in short-term debt	23,800	142,000
Sale of stock under benefit plans	26,198	5,630
Purchase of treasury shares	(74,572)	(186,331)
Dividends to shareholders	(16,657)	(13,909)
Debt issuance costs		(8,344)



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Cash Used by Financing Activities	(41,231)	(301,542)
DISCONTINUED OPERATIONS:		
Cash used by operating activities from discontinued operations	(839)	(2,377)
Cash provided by investing activities from discontinued operations		1,656
Cash Used by Discontinued Operations	(839)	(721)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	6,841	2,929
DECREASE IN CASH AND CASH EQUIVALENTS	(73,596)	(127,397)
Cash and Cash Equivalents at Beginning of Year	144,713	213,613
Cash and Cash Equivalents at End of Period	\$ 71,117	\$ 86,216

See notes to condensed consolidated financial statements (unaudited).

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**AMERICAN GREETINGS CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Three and Nine Months Ended November 23, 2007 and November 24, 2006**

**Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of American Greetings Corporation and its subsidiaries (the Corporation) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary to fairly present financial position, results of operations and cash flows for the periods have been included.

The Corporation's fiscal year ends on February 28 or 29. References to a particular year refer to the fiscal year ending in February of that year. For example, 2007 refers to the year ended February 28, 2007.

These interim financial statements should be read in conjunction with the Corporation's financial statements and notes thereto included in its Annual Report on Form 10-K for the year ended February 28, 2007, from which the Condensed Consolidated Statement of Financial Position at February 28, 2007, presented herein, has been derived. Certain amounts in the prior year financial statements have been reclassified to reflect certain business units as discontinued operations and adjusted to reflect the Corporation's adoption of Staff Accounting Bulletin No. 108 (SAB 108). The opening balance of retained earnings in 2007 was adjusted \$5.2 million (\$3.3 million after-tax) to record the correction of the overstatement of the allowance for rebates (correspondingly, an understatement of net income of prior periods) pursuant to the special transition provision detailed in SAB 108.

Certain amounts in the prior year financial statements have also been reclassified to conform to the 2008 presentation. Previously included in Other income net, royalty revenue is now reported as Other revenue and interest income is now included as a separate line item on the Condensed Consolidated Statement of Income. The remaining items previously included in Other income net have been segregated between operating and non-operating.

**Note 2 Seasonal Nature of Business**

A significant portion of the Corporation's business is seasonal in nature. Therefore, the results of operations for interim periods are not necessarily indicative of the results for the fiscal year taken as a whole.

**Note 3 Recent Accounting Pronouncements**

In July 2006, the Financial Accounting Standards Board (the FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertain tax positions recognized in a company's financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes, including what criteria must be met prior to recognition of the financial statement benefit of a position taken or expected to be taken in a tax return. FIN 48 requires a company to include additional qualitative and quantitative disclosures within its financial statements. The disclosures include potential tax benefits from positions taken for tax return purposes that have not been recognized for financial reporting purposes and a tabular presentation of significant changes during each annual period. The disclosures also include a discussion of the nature of uncertainties, factors that could cause a change and an estimated range of reasonably possible changes in tax uncertainties. FIN 48 requires a company to recognize a financial statement benefit for a position taken for tax return purposes when it is more likely than not that the position will be sustained. The cumulative effect of adopting FIN 48 is recorded as an adjustment to the opening balance of retained earnings in the period of adoption. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Corporation adopted FIN 48 on March 1, 2007. See Note 12.

In September 2006, the FASB issued SFAS No. 157 (SFAS 157), Fair Value Measurements, which provides a definition of fair value, establishes a framework for measuring fair value and requires expanded disclosures about

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fair value measurements. In November 2007, the FASB agreed to defer the effective date of SFAS 157 for non-financial assets and liabilities until fiscal years and interim periods beginning after November 15, 2008. SFAS 157 is still effective for the Corporation in fiscal 2009 for financial assets and liabilities. The provisions of SFAS 157 will be applied prospectively. The Corporation is currently evaluating the impact that SFAS 157 will have on its consolidated financial statements upon adoption.

**Note 4 Other Income and Expense**

(In thousands)	Three Months Ended		Nine Months Ended	
	November 23, 2007	November 24, 2006	November 23, 2007	November 24, 2006
Gain on contract terminations	\$	\$ (20,004)	\$	\$ (20,004)
Other	(127)	(537)	(807)	(959)
Other operating income net	\$ (127)	\$ (20,541)	\$ (807)	\$ (20,963)
Foreign exchange gain	\$ (4,054)	\$ (610)	\$ (6,323)	\$ (2,348)
Rental income	(274)	(261)	(949)	(1,044)
Other	(254)	962	(206)	581
Other non-operating (income) expense net	\$ (4,582)	\$ 91	\$ (7,478)	\$ (2,811)

Other includes, among other things, gains and losses on asset disposals and equity income. The \$20.0 million gain on contract terminations was a result of retailer consolidations, wherein, multiple long-term supply agreements were terminated and a new agreement was negotiated with a new legal entity with substantially different terms and sales commitments.

**Note 5 Earnings Per Share**

The following table sets forth the computation of earnings per share and earnings per share - assuming dilution:

	Three Months Ended		Nine Months Ended	
	November 23, 2007	November 24, 2006	November 23, 2007	November 24, 2006
<b>Numerator (in thousands):</b>				
Income from continuing operations	\$ 29,488	\$ 47,015	\$ 68,836	\$ 51,008
Add-back interest on convertible subordinated notes, net of tax				1,958
Income from continuing operations assuming dilution	\$ 29,488	\$ 47,015	\$ 68,836	\$ 52,966
<b>Denominator (in thousands):</b>				
Weighted average shares outstanding	55,023	59,502	55,351	58,591
Effect of dilutive securities:				
Convertible debt				5,353
Stock options and other	443	400	376	418

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Weighted average shares outstanding assuming dilution	55,466	59,902	55,727	64,362
Income from continuing operations per share	\$ 0.54	\$ 0.79	\$ 1.25	\$ 0.87
Income from continuing operations per share assuming dilution	\$ 0.53	\$ 0.79	\$ 1.24	\$ 0.82

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Approximately 1.3 million and 1.7 million stock options outstanding in the three and nine month periods ended November 23, 2007, respectively, were excluded from the computation of earnings per share-assuming dilution because the options' exercise prices were greater than the average market price of the common shares during the respective periods (2.5 million and 4.4 million stock options outstanding in the three and nine month periods ended November 24, 2006, respectively). The convertible debt was retired during the second quarter of 2007.

**Note 6 Comprehensive Income**

The Corporation's total comprehensive income is as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>November 23, 2007</b>	<b>November 24, 2006</b>	<b>November 23, 2007</b>	<b>November 24, 2006</b>
<b>(In thousands)</b>				
Net income	\$ 29,016	\$ 49,707	\$ 67,441	\$ 54,601
Other comprehensive income (loss):				
Foreign currency translation adjustment and other	11,614	6,018	23,318	25,896
Unrealized gain (loss) on securities		323	(1)	348
Pension and other postretirement benefit plans	678		678	
Total comprehensive income	\$ 41,308	\$ 56,048	\$ 91,436	\$ 80,845

**Note 7 Trade Accounts Receivable, Net**

Trade accounts receivable are reported net of certain allowances and discounts. The most significant of these are as follows:

**(In thousands)**